

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1618, *United States Government Supply Contracts*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1618, *United States Government Supply Contracts*. Regulation 1618 implements, interprets, and makes specific RTC section 6207, which provides that the term "retail sale" means "a sale for any purpose other than resale in the regular course of business," and RTC section 6381, which provides an exemption from sales tax for gross receipts from the sale of tangible personal property to the United States. The proposed amendments make the regulation consistent with the 2007 amendments to the Federal Acquisition Regulation (FAR) codified in chapter 1 of title 48 of the Code of Federal Regulations, and clarify the requirements for making sales for resale to the United States of direct consumable supplies and indirect consumable supplies, including overhead materials.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on June 26-28, 2012. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on June 26, 27, or 28, 2012. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1618.

AUTHORITY

RTC section 7051.

REFERENCE

RTC sections 6007 and 6381.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Regulation 1618

Unless an exemption applies, California imposes a sales tax on retailers, which is measured by their gross receipts from the retail sale of tangible personal property in California. (Rev. & Tax Code, § 6051.) As relevant here, RTC section 6007 provides that the term "retail sale" means "a sale for any purpose other than resale in the regular course of business" and RTC section 6381 provides an exemption from sales tax for gross receipts from the sale of tangible personal property to the United States.

Regulation 1618 currently prescribes the circumstances under which a retailer may make non-taxable sales of tools, equipment, direct consumable supplies, and overhead materials to a United States Government supply contractor who will resell the tangible personal property to the United States Government in the ordinary course of the contractor's business (hereafter, "sales for resale to the United States"). The regulation generally provides that:

- A retailer's sales of tools, equipment, direct consumable supplies, and overhead materials to a United States Government supply contractor are sales for resale to the United States if the United States takes title to the tangible personal property pursuant to a United States Government supply contract prior to the time the contractor uses the property to perform the function or act for which the property was designed or manufactured; and
- A retailer's sales of tools, equipment, direct consumable supplies, and overhead materials to a United States Government supply contractor are not sales for resale to the United States if the contractor makes any use of the property to perform the function or act for which the property was designed or manufactured prior to the time that title to the property passes to the United States.

Regulation 1618 also currently provides specific guidance for determining when title to direct consumable supplies and overhead materials passes to the United States under a United States Government supply contract. In addition, the United States Government has uniform acquisition policies and procedures for its executive agencies, which are codified in the FAR, and Regulation 1618 provides specific guidance as to when title to "special tooling" passes to the United States under the FAR.

2007 Amendments to FAR

Regulation 1618 was last amended in 1995 to provide specific guidance for determining when title to overhead materials passes to the United States in accordance with the Court of Appeal's decision in *Aerospace Corporation v. State Board of Equalization* (1990) 218 Cal.App.3d 1300, and when title to "special tooling" passes to the United States in accordance with FAR part 52.245-17. However, the federal government amended the FAR in 2007, and, among other changes, repealed FAR part 52.245-17, which contained special title passage clauses applicable to contracts for "special tooling," and consolidated a number of clauses regarding the passage of title to the federal government into FAR part 52.245-1, effective June 14, 2007.

Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1618

The Board directed its staff to meet with interested parties to discuss whether Regulation 1618 needs to be amended due to the repeal of FAR part 52.245-17 and any other changes in United States Government supply contracts. At the conclusion of the interested parties process, Board staff prepared Formal Issue Paper 12-001, which raised the issue of whether the Board should amend Regulation 1618 to conform to changes in the FAR, and recommended that the Board amend Regulation 1618 to:

- Delete the provisions in subdivision (a)(2) providing that the term “tools,” as used in the definition of direct consumable supplies, does not include “special tooling”;
- Add new provisions to subdivision (a)(2) specifying that, effective June 14, 2007, the term “tools,” as used in the definition of direct consumable supplies, includes “special tooling” that “was previously covered by FAR part 52.245-17”; and
- Amend the second to last sentence in subdivision (b) to reflect that the FAR’s title passage clauses for special tooling applied until Jun 13, 2007, but were no longer effective after that date.

In addition, Formal Issue Paper 12-001 recommended that the Board amend Regulation 1618, subdivision (a)(3) to clarify that costs for “overhead materials” must be allocated to United States Government supply contracts “consistent with government cost accounting standards.” It also recommended that the Board clarify the guidance provided in subdivision (b) regarding the passage of title to “direct consumable supplies” and “overhead materials” by separating subdivision (b) into paragraphs (1) through (3), explaining that overhead materials are one example of “indirect consumable supplies,” and providing distinct guidance regarding the passage of title to direct consumable supplies, which are directly reimbursable under specific contracts, and indirect consumable supplies, which must be allocated to specific contracts.

The Aerospace Industries Association (AIA) participated in Board staff’s meetings with the interested parties and AIA agreed with staff’s recommended amendments to Regulation 1618 as set forth in Formal Issue Paper 12-001.

During its March 20, 2012, Business Taxes Committee meeting, the Board determined that staff’s recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1618 consistent with the 2007 amendments to the FAR and clarifying Regulation 1618’s guidance regarding sales for resale to the United States of direct consumable supplies and indirect consumable supplies, including overhead materials. The proposed amendments are anticipated to provide the following specific benefits:

1. Ensure that Regulation 1618 is consistent with the amendments made to the FAR effective June 14, 2007;

2. Eliminate confusion regarding the treatment of special tooling after the 2007 amendments to the FAR;
3. Explain that overhead materials are one example of indirect consumable supplies; and
4. Provide more certainty regarding sales for resale to the United States of direct consumable supplies and indirect consumable supplies, including overhead materials.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1618 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1618 is the only state regulation prescribing the requirements for making sales for resale to the United States. In addition, there is no federal sales tax and there are no comparable federal regulations or statutes to Regulation 1618.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1618 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1618 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The proposed amendments to Regulation 1618 make the regulation consistent with the 2007 amendments to the FAR, eliminate confusion regarding the treatment of special tooling after the 2007 amendments to the FAR, and provide more clarity and certainty regarding the requirements for sales for resale of direct consumable supplies and indirect consumable supplies, including overhead materials, to the United States. The proposed amendments were the result of a collaborative effort between Board staff and the interested parties and are intended to provide additional certainty to retailers. Furthermore, the proposed amendments will not impose any new taxes. Therefore, the Board has made an initial determination that the adoption of the proposed amendments to Regulation 1618 will not have a significant, statewide adverse economic impact directly

affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1618 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1618 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1618 will not affect the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Regulation 1618 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at

(916) 445-2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on June 26, 2012, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Regulation 1684 during the June 26-28, 2012, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1618. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1618 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1618 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1618, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.